

Prospects of Privatization of Peat Enterprises in the Republic of Belarus

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Summary

Since peat-making companies are all located in smaller settlements and provide jobs for a considerable part of the able-bodied population, the state will see to it that investors meet a number of conditions when purchasing the state shareholdings in newly privatized peat suppliers, although additional conditions imposed on sales of the state stakes will definitely reduce the profitability of extraction and processing.

Background

Belarus is rich in peat and sapropel deposits, with peatlands covering around 2.4 million hectares. Peat reserves in place are estimated at 4 billion tonnes.

The chief task of the peat-processing industry is to meet the requirement of households, public utility consumers, and fuel and energy complex of the country as a whole for peat fuel and peat-based products, namely, peat briquettes, lump peat, fuel peat, fertilizers, peat compost and highbog peat.

Belarusian peat-processing companies are developing 46 peat deposits; some of the exploitations are used in agribusiness and forest management, and some are partially included in nature reserves.

All peat resources of Belarus fall into the following reserves (funds): environmental, land, exploited, back-up, vacant, and cutover.

Given the abundance of peat reserves (peat bogs cover some 14% of the territory of Belarus) and high value of its organic part, a package approach to peat production and utilization is called for, especially when it comes to the varieties used to manufacture the products and materials that cannot be procured using alternative environmental assets.

In the 1980s-1990s, the peat industry of Belarus was gradually falling into decay. The state had shifted its focus to oil processing, installation of gas service in rural areas and switching power generation facilities to gas fuel.

Energy preparedness was back in the limelight once Belarus was faced with interrupted deliveries of natural gas from Russia.

Program of actions to address problems of peat-processing enterprises

There have been a few stages in the program to recover the peat industry since 2003.

Firstly, a Program of financial and economic rehabilitation of peat-processing enterprises for 2003-2005 was adopted by the Energy Ministry on June 17, 2003. The ministry earmarked 61.5 billion Belarusian rubles from its innovation fund to finance the program, which proved efficient enough to strengthen peat manufacturers and improve their performance.

Secondly, the state program "Peat" was launched in 2008 to cover the period 2008 through 2010 and outline actions until 2020.

Measures to address the problems of the peat sector have so far been taken exclusively by the state.

It does not mean, though, that no other party is interested in bettering the situation in the peat industry. Judging by the information available from free sources, foreign investors are genuinely interested in the peat-processing industry of Belarus.

During the conference "Improvement of Conditions for Foreign Investment" arranged by the OSCE Parliamentary Assembly's Working Group on Belarus in Minsk on March 11, 2009, Dr. Rainer Lindner with the Eastern Europe Relations Committee, Germany, cited Russia's Joint Agency for Alternative and Renewable Energy Sources as a positive example of cooperation between the authorities and investors.

There are two possible scenarios for the development of the Belarusian peat industry:

Scenario 1. The state privatizes peat-making enterprises by transforming them into open joint-stock companies with a state shareholding of 100% and opts for keeping the whole stock to itself while financing further upgrade from the innovation fund and other budget funds.

Scenario 2. After transforming the enterprises in question, the state sells a part of its shareholdings to investors.

Regulatory acts applicable to the peat industry

The peat industry is an integral part of the fuel and energy complex of Belarus.

Peat has five broad application areas in Belarus: fuel and energy, agribusiness, chemical engineering, balneology and medicine, and environment.

Belarus produced 36 million tonnes of peat back in 1976; by 2005, production volumes had dropped to 2 million tonnes. In 2007, Belarus produced 2.8 million tonnes of peat. By 2020, the country plans to process 1.5 million tonnes of fuel equivalent for the fuel and energy sector and up to 3 million tonnes of peat for agriculture annually.

The remaining acts regulating the operation of peat-processing enterprises include:

- State program "Peat" for 2008-2010 and the period until 2020, adopted by Resolution #94 of the Council of Ministers dated January 23, 2008.
- State integrated program of modernization of the basic production assets of the Belarusian energy system, energy saving and increase in the share of domestic fuel and energy resources in the country for the period until 2011, adopted by Ordinance of the President #575 dated November 15, 2007.

- Targeted program aimed at provision of at least 25% of overall electricity and thermal power generated in Belarus from local fuels and alternative fuel resources for the period until 2012, adopted by Resolution #1680 of the Council of Ministers dated December 30, 2004.
- Code on Mineral Resources #406-3 dated July 14, 2008.
- Basic provisions of the mechanism of sustainable utilization and protection of peat resources of the Republic of Belarus for the period until 2010 adopted by Resolution #440 of the Council of Ministers dated November 25, 1991.
- Action plan to intensify exploration and development of mineral resources of the Republic of Belarus in 2006-2010 adopted by Resolution #671 of the Council of Ministers dated June 21, 2005.
- State program of rehabilitation and development of the village for 2005-2010 passed by Ordinance of the President #150 dated March 25, 2005.
- Provision on licensing of activities involving utilization of natural resources and environmental modification adopted by Resolution #1371 of the Council of Ministers dated October 20, 2003. Mining operations are classified as a licensed activity without indicating specific natural resources (at the present time licensing applies to extraction of peat or sapropel).

The objective of this report is to identify the development patterns of separate enterprises and the peat sector as a whole, given current regulations and modern privatization tendencies in the Republic of Belarus.

The report will address the forms of incorporation of peat manufacturers, their financial and economic status, analyze privatization processes, and give examples of foreign peat-producing leaders.

Forms of incorporation of Belarusian peat producers

The state production association Beltopgaz, which is responsible for fuel supplies and installation of gas service, supervises 34 enterprises of the Belarusian peat industry. Thirty-one enterprises extract and process peat, of them 22 produce peat briquettes and three manufacture engineering solutions for the peat industry.

Below are the three basic forms of incorporation of the Belarusian peat enterprises: republican unitary enterprises, open joint-stock companies and subsidiaries.

It should be noted that before the government adopted the Republican property privatization plan for 2008-2010 there had been only two forms of incorporation, namely, republican unitary enterprises and their subsidiaries. Moreover, before "Peat" program was adopted, the peat sector had been the exclusive domain of republican unitary enterprises.

The current reform and privatization efforts of the state have been necessitated by the poor financial health of the domestic peat producers.

According to "Peat" data, there were six loss-making peat enterprises in 2006, whereas in January-November 2007, there were 10. To stabilize the operation of peat-producing enterprises and improve their financial indicators the government reorganized some of the state-run power- and gas-supplying organizations by attaching the following loss-making peat manufacturers to them: PRUTP (Production republican unitary peat enterprise) Berezovskoe of Ivatsevichi District, PRUT Usvizh-Buk of Tolochin District, PRUT Osintorf of Dubrovno District, PRUT named after Dauman of Shumilino District, UP (unitary enterprise) Vitebskoe of Dokshitsy District, PRUT Pervoe Maya of Chashniki District, PRUTP Belitskoe of Rogachev District, RUP TBZ Khoinikovski of Khoiniki township, UPP named after 23rd CPSU Congress of Berezino District, PRUTP Sergeevichskoe of Pukhovichi District.

For instance, the peat enterprise Sergeevichskoe in 2007 was reorganized through transformation into a subsidiary of RUP Mingaz. In 2008, RUP Mingaz provided serious financial assistance to its "acquisition" and helped the peat suppliers procure new machinery.

PRUT Osintorf was attached to BelGRES (a state-owned district power plant) and became the official peat supplier to the plant. BelGRES turned into one of the first heat power stations of the country to work on local resources – waste wood and peat – instead of natural gas, and in 2006 implemented a pilot project to construct a power unit working on a mixture of wood fuel and peat. To meet the peat requirement of the power plant and launch new peat utilization projects BelGRES plans to reclaim an additional 160,000 hectares of peatbogs. The power plant started developing new sites for peat extraction, because further increases in peat consumption will cut the dependence on expensive natural gas and fuel oil.

Financial and economic situation at Belarusian peat-processing enterprises

A typical peat-making enterprise owns property, such as briquette and transport shops, extracting and transportation equipment, like loaders, tractors, rail cars, cranes and railways. Extracted peat is normally delivered to processing units by narrow-gauge locomotives (at 27 enterprises).

Most of the peat-extracting and processing enterprises have operated for over 40 years now, and no two are alike; nevertheless, we will take a typical peat maker, Starobin peat briquette plant, to define the features common to all peat enterprises of Belarus.

Starobin peat briquette plant is the principal employer and mainstay of the town of Starobin, with 370 personnel. The plant accounts for 40% of all Starobin able-bodied residents involved in industrial production.

Production republican unitary enterprise (PRUP) Starobin peat briquette plant was founded in 1972. The design capacity of the production is 200,000 briquettes a year, but the output capacity had been falling because of the dwindling supplies of milled peat (caused by non-allocation of land), so by the time "Peat" was adopted there had been no plans to increase production. In 2005, Starobin peat briquette plant put out 181,900 tonnes of peat briquettes and extracted 322,700 tonnes of milled peat.

In 2006-2010, the producer is supposed to refit its briquette shop and upgrade extraction and transportation units: capital consumption was at 64.3% as of January 1, 2007 (according to "Peat"), and deterioration of primary equipment was estimated at 71.1%. When thoroughly analyzed, most of the extractive and maintenance equipment proved almost completely used-up; the 750-millimeter gauge rail transport required technical upgrade, and so did the equipment of briquette-making shops.

Ordinance of the President #27 dated January 13, 2006 restructured overdue payables of ten peat-processing enterprises by granting them respites to pay and allowing payments in installments within five, three or two years depending on the type of payments. Eight out of ten loss-makers were later reorganized and attached to other organizations (following the scheme we described above), and two more – PRUT Oshmyanskoe and PRUT Gantsevichskoe – were included in the list of state-controlled entities subject to privatization in 2008-2010.

Technical upgrade of peat producers has been financed from the innovation fund of the Energy Ministry, enterprises' own funds and, if there is a shortage, from the republican budget. Some funds were raised through sale of peat companies' property: resolution

#1618 of the Council of Ministers dated November 27, 2007 authorized auctioning of real property belonging to peat enterprise Kolpenitsa; the sales proceeds were channeled into the upgrade of Kolpenitsa production facilities. Neither the state program "Peat" nor any other legislative act regulating the work of the sector indicates whether the peat industry is advised to invite foreign investment, and if yes, how much it should attract and in what way.

Anyway, foreign investors appear to be quite interested in Belarusian peat companies. The director of the Lithuanian peat-processing company Plinksiu Vilištra, Almentos Valteris, visited Lida-based counterparts in late December 2008. There were media reports that the Lithuanian businessman suggested setting up a joint venture in the district. He had been studying opportunities for expanding peat extraction and later negotiated possibilities of increasing processing volumes with a view of raising export supplies of peat products.

The chief characteristic features of the Belarusian peat industry are as follows:

- they are located in small settlements and offer a rare chance of employment;
- the capital consumption rate is high;
- there are personnel problems;
- the modernization is stepwise and is financed from state funds.

Peat industry privatization process

The schedule of privatization of enterprises in the republican ownership for 2008-2010 includes 20 peat enterprises (Appendix 1).

Six peat producers were privatized in 2008 through share issue, nine more are expected to go public in 2009, and the remaining five will issue shares in 2010.

Last year's privatization followed the beaten path – the peat manufacturers were transformed into open joint-stock companies with the state acquiring a 100% stake. The pattern will definitely be kept unchanged in 2009 and 2010.

Therefore, the key objective of the state privatization efforts indicated in Clause 4 of Article 1 of the law "On denationalization and privatization of state property in the Republic of Belarus" (that is, for the state to cease to be entitled to property, fully or partially, waive its utilization and management rights, and for state authorities to forfeit their rights to exercise direct control) was not achieved.

This privatization mechanism was picked as a priority last year. The state transforms its enterprises, acquires a 100% shareholding and strengthens its bargaining positions. The State Property Committee reported successful transformation of 156 state-controlled enterprises in 2008, out of 161, and establishment of 107 joint-stock companies, including one with Russian capital.

The only high chance for a foreign investor to get hold of a large shareholding in a state-run enterprise subject to privatization is to take part in the denationalization process during the stage when the enterprise issues shares (thus turning into a joint-stock company), whereas the state profits by attracting a trustworthy investor in the shortest and fastest way possible.

The tentative joint venture with Lithuania's Plinksiu Vilištra we mentioned above could be held up as a fine example of privatization during the share issue phase: the meeting in Lida (the administration of that town promised to support the project) was attended by directors of two more peat enterprises – PRUT Ditva and PRUT Lidskoe – both included in the privatization plan for 2008-2009.

Anyway, even if investors fail to appear in a year or two, the transformation of state-run enterprises is in itself a positive shift, because it eliminates property accounting drawbacks.

The process of reorganization of a unitary state-controlled enterprise calls for a package of special measures, one of them being the formation of a charter fund (capital), which is based on the balance sheet value of assets as of January 1 of the current year (which, in its turn, is based on the inventory and valuation of assets and liabilities in accordance with the established procedure).

The charter fund thus includes the property of the state unitary enterprise subject to privatization, unless required otherwise by applicable regulations.

The procedure of finalization of the charter fund therefore involves an audit of financial and economic activities of the state unitary enterprise subject to share issue and stock-taking of its assets and liabilities. These measures often result in discoveries of excessive stock, surpluses, unaccounted constructions, etc., which must be duly accounted for.

Under Instruction of the State Property Committee of the Republic of Belarus #199 dated July 22, 2008, which adopted a provisional list of activities to establish an open joint-stock company as a result of privatization of an entity in the republican ownership, the organizations included in the plan of privatization of such entities are supposed to take the following actions to prepare for privatization: to take stock of assets and liabilities, which includes checks of inventory cards for each article, stock books, catalogues and other analytical accounting registers; categorization of fixed assets; asset numbers; technical passports for buildings and constructions (if they are recognized as property units); land registration documents (including land allocation resolutions of local authorities and land use acts); documents confirming the availability of fixed assets leased by the organization or in deposit with the organization; and availability of property owned by the Republic of Belarus, including property units, land plots and entities in the process of construction.

Some of the peat manufacturers and suppliers have company housing facilities on their books, with engineering services (heat and electric mains, water supply systems, drainage systems, etc.) and social infrastructure. The total area of housing facilities is over 89,000 square meters.

Under state program "Peat", departmental housing facilities are expected to be transferred to communal ownership to facilitate their maintenance and timely repairs.

Upon completion of privatization procedures, social infrastructure entities may be transferred to emerging organization under free use agreements without the right of disposal, or to relevant administrative units.

Importantly, peat-processing enterprises are on the list of companies "dominating on commodity markets", therefore Paragraph 26 of the Provision of the State Property Committee adopted by Instruction #96 dated June 18, 1998 "On development of projects to establish open joint-stock companies as a result of denationalization and privatization of state property" has it that before filing an application for transformation of state property into an open joint-stock company through denationalization and privatization, the commission initiating such a transformation should complete a package of preparatory operations, including coordination of transformation conditions with the pricing policy department of the Economy Ministry of Belarus or pricing policy sections of regional and Minsk executive committees.

The law "On denationalization and privatization of property in the republican ownership" and Decree of the President #3 with the same name dated March 20, 1998 indicate joint-

stock companies may be founded by the State Property Committee or investors. Moreover, during the gratis privatization campaign, up to 50% of state-owned shares in open joint-stock companies created as a result of denationalization of unitary and leased enterprises were exchanged for Property vouchers in accordance with the established procedure.

However, when addressing peat industry privatization methods, we should note that Ordinance of the President #605 dated November 10, 2008 "On privatization of state unitary enterprises" adopted a list of enterprisers whose shares, if controlled by the Republic of Belarus, will not be subject to sales on easy terms or exchange for Property privatization vouchers; the 20 peat-extracting and processing enterprises in the privatization schedule for 2008-2010 are on that list.

It appears there are two possible scenarios (we mentioned them above): on the one hand, the inclusion of Belarusian manufacturers, including peat producers, in the list adopted by Ordinance #605 will enable the state to offer large shareholdings (and avoid dispersion of interests) to potential investors and receive substantial funds for the state budget. On the other hand, the state program "Peat", which envisages a package of measures to develop the branch, as well as real financial investment from the budget (for modernization of production and procurement of machinery, etc.) make it clear that the probability of financing by privately-owned entities is not high. We can easily extrapolate the position of the state on privatization processes from the statement the president made during his visit to OAO Babusklina krynka dairy farm, in the city of Mogilev. As is known, the state had been investing heavily in the upgrade of domestic dairies, and the completion of the modernization program being so close, there was need for hasty privatization moves, according to the head of state. This scenario will most likely be followed once again after the state decides it is time to privatize its peat producers.

Experience of other countries

The global leaders in peat processing and production are Finland, Canada and the U.S.

Finland has established state control of the peat industry as a strategic branch of economy. State management company VAPO accounts for 82% of the peat market and Turveruukki Oy has a 7% market share. Some two hundred small private firms account for the remaining 10% of the peat market.

Finland is the leading country of the world by the share of peat in the energy balance: around 17% of power generated in Finland comes from peat. In Northern Ostrobothnia alone, about 86% of power is generated from peat.

Most of the jobs connected with peat extraction and processing are in the regions, where there are hardly any other jobs. Finland had opted for the diversification of production, instead of having combined peat manufacturing units. The largest Finnish peat companies prefer placing contracts for peat exploitation with small family businesses and often provide machinery and know-how, especially for extraction procedures and reclamation of drained lands.

Over the past 20 years Finns have succeeded in upgrading Soviet machines, while peat-based power engineering was granted a priority status. Finland produces around 10 million tonnes of peat annually.

Russia boasts 47% of the world peat reserves. The energy potential of Russian peat reserves in fuel equivalent terms (68 billion tonnes) exceeds that of oil, natural gas and wood reserves and is second only to coal deposits. Peat is efficient on a small scale, though, – in smaller settlements and municipal boiler rooms, which currently use imported coal and fuel oil.

But it was not until quite recently that Russia started considering utilization of local fuels, including peat, on a wider scale, in an attempt to increase the share of local renewable fuels in the overall fuel and energy balance (which now stands below 1%). The Russian Energy Strategy encompassing the period until 2020 envisages a manifold increase in the usage of peat.

Specialists note the following obstacles to the development of the peat industry: significant risks caused by unstable regulations, decay of peat engineering, deficit of skilled personnel, shortage of manpower resources, seasonal nature of peat operations and general slump in the industry.

The Russian Energy Committee is trying its best to streamline the regulatory framework for peat companies. The current framework, including the Forest and Water Codes, obliges peat-extracting companies to take out subsoil use licenses, which runs counter to the very nature of peat, as it is located "in bogs, in other words, surface-water bodies, that is, beyond the 'subsoil' realm," reads a memorandum of the Committee. There is indeed a variety of peat called "subsurface peat", but it is not profitable to extract it now that huge reserves of easily extractible peat are up for grabs.

The businesses that act on the basis of subsoil use licenses are expected to pay the severance tax and make a number of other payments in accordance with the law on mineral deposits. Also, they are supposed to pay the rent for lands covered in bogs.

Despite the difficulties, regional fuels, including peat extraction and processing, became an attractive investment destination: natural gas giant Gazprom and some oil majors set up their own peat companies, for instance, in Novgorod and Pskov regions. Lukoil-related businesses have acquired four peat factories in Leningrad region and took just 12 months to break even and declare profits. Banks and regional administration are eager to invest in peat, too. Federal authorities plan to open 31 new peat-making plants in the next 10 years.

Specialists advise Russian administrations to mull joint peat projects with Belarusian energy enterprises – they believe the Belarusian national energy system will be using as much local fuel as possible, including vast peat reserves. Experts suggest joint re-equipment of the peat industry in both countries in order to develop peat processing for various purposes. One of the most promising domains for local fuels is autonomous rural power engineering, which may burn peat, wood, and low-grade coal as well as agricultural waste, – once developed and flourishing, this sector will become the key to restoring the economic potential of rural areas of Russia's Non-Chernozem Belt.

It is clear from the examples above that the peat industry has a strong investment appeal, provided that rational management approaches are adopted. The interest of investors and the state in the peat sector seems to be growing from year to year.

Conclusion

1. Twenty peat-producing enterprises will issue shares in 2008-2010; the state will retain 100% shareholdings.
2. Transformation into open joint-stock companies will enable the enterprises to rectify property accounting drawbacks
3. Investors will be able to acquire shareholdings in newly established joint-stock companies depending on the following factors:
 - resolution of the authorities to reform the fuel and energy complex of the country instead of the current case-by-case privatization;

- amendments to the regulatory framework of privatization aimed at increasing the investment appeal of Belarusian companies and privatization capabilities.

4. Belarus has not adopted the law "On local fuels and alternative renewable energy sources" yet. When approved, the law could be used as the foothold for other regulatory moves aimed at developing the sector and attracting investment.

5. In a few years to come the industry will be developed with state support and financed from the innovation fund of the Energy Ministry, the republican budget and profits of peat manufacturers themselves.

6. State investment in the upgrade of peat companies, restructuring of their debts and the analysis of privatization experience in other branches of economy (and naturally the approach of the authorities to sale of shares in privatized entities) suggest that the state has no plans to sell shareholdings in peat producers in the foreseeable future.

7. Since most of the peat-extracting and processing companies are based in smaller settlements and provide jobs for a considerable share of able-bodied local inhabitants, interests in privatized companies may be sold to investors (see #3) only if they are ready to meet a number of requirements, although the state is aware that additional sales conditions will affect the profitability of extraction and processing.

8. The peat mining and processing trends currently observed in the countries that have the largest peat reserves show that the peat industry is a promising investment destination, however, specialists advise the following strategy for the organization and development of new generation peat exploitation: the backbone of the industry should be formed by profitable small-capacity processing companies located in close proximity to peatlands and specific consumers, depending on what these consumers need and what they are ready to pay for.